TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1924.

No. 413

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER,

vs.

[illegible]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. 413

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER,

vs.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

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BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

GULF, MOBILE & NORTHERN RAILROAD CO.

vs.

COMMISSIONER OF INTERNAL REVENUE

For Taxpayer: Geo. E. H. Goodner, Esq.
For Commissioner: E. C. Algire, Esq.

DOCKET ENTRIES

1928

Dec. 31. Petition received and filed. Taxpayer notified. (Fee paid.)

1929

Jan. 2. Copy of petition served on General Counsel.

Mar. 2. Answer filed by G. C.

" 16. Copy of answer served on taxpayer, assigned general calendar.

Oct. 28. Motion to place on circuit cal. at Mobile, Ala. filed by taxpayer.

" 31. Motion granted.

1930

Feb. 1. Hearing set Mar. 10, 1930 at Mobile, Ala.

" 26. Hearing set 3-31-30 at Mobile, Ala. (Revised notice.)

Apr. 4. Hearing had before Chas. M. Trammell, Div. 2, on merits. Amended petition filed; copy served on respondent; answer read into record; dockets 24887-35898-38295-42149 consolidated for hearing and decision. Briefs due 60 days from date.

" 16. Transcript of hearing at Mobile Ala. 4-2-30 filed.

June 13. Motion for 30 days extension to file brief, filed by taxpayer. 6-17-30 Granted.

" 30. Brief filed by G. C.

July 26. Motion to correct the record filed by taxpayer. 7-31-30 Granted.

1930

July 29. Motion for extension of 30 days to file brief, filed by taxpayer. 7-30-30 Granted.

Aug. 26. Brief filed by taxpayer.

[fol. 6]

1931

Feb. 20. Findings of fact and opinion rendered, Chas. M. Trammell; judgment will be entered under Rule 50.

May 15. Motion to correct findings and opinion filed by taxpayer.

" 15. Proposed settlement under Rule 50 filed by taxpayer.

" 21. Hearing set May 28, 1931 on settlement.

" 21. Hearing set May 28, 1931 on motion.

" 26. Order that proceedings be stricken from day calendar of 5-28-31 and continued sine die, entered.

" 22. Copy of motion and notice of hearing date served on G. C.

July 8. Hearing set Aug. 5, 1931 on motion.

" 6. Motion for Board to correct its opinion of Feb. 20, 1931 filed by G. C.

" 6. Notice of settlement filed by G. C.

" 8. Hearing set Aug. 5, 1931 on settlement.

Aug. 5. Hearing had before Chas. P. Smith, Div. 5, on motion to correct opinion; by consent continued to Sept. 9, 1931.

" 5. Order continuing hearing to Sept. 9, 1931.

" 18. Motion for continuance to Sept. 23, 1931, filed by G. C. 8-19-31 Granted.

Sept. 23. Hearing had before Mr. Trammell on respondent's motion to correct opinion. Notice of settlement filed.

Sept. 30. Order modifying and amending opinion, entered.

" 30. Decision entered, C. M. Trammell, Div. 2.

" 28. Transcript of hearing of 9-23-31 filed.

Nov. 2. Motion to vacate and set aside decision and to substitute attached decision, filed by taxpayer.

" 7. Revised decision entered—C. M. Trammell, Div. 2.

Dec. 4. Motion to set aside decision of Nov. 7, 1931 and to reconsider decision of Feb. 20, 1931, filed by G. C.

1931.

Dec. 9. Hearing set Dec. 16, 1932 on motion.
" 16. Hearing had before Mr. Trammell on respondent's motion to set aside decision. Taken under advisement.

[fols. 7-29]

Dec. 19. Order that respondent's motion to set aside final decision of 11-7-31 and reconsider decision promulgated 2-20-31 be granted and that decision of Board entered 11-7-31 be modified entered.
" 21. Order that petitioner's objection and exception to order of Dec. 19, 1931 be made a matter of record, entered.

1932

Jan. 25. Motion for settlement without prejudice & agreed to by G. C., filed by taxpayer.
" 25. Order that revised decision entered Nov. 7, 1931 be vacated and set aside and second revised decision entered, C. M. Trammell, Div. 2.
Mar. 22. Transcript of hearing Dec. 16, 1932 filed.
July 25. Stipulation to have case reviewed by Court of Ap. of D. C. filed.
" 25. Petition for review to Ct. of Appeals of D. C. with assignments of error filed by taxpayer.
" 25. Proof of service filed.
Sept. 19. Motion for extension to 10-23-32 to prepare and transmit record filed by taxpayer.
" 19. Order enlarging time to 10-23-32 to prepare and transmit record entered.
Oct. 18. Præcipe with proof of service thereon filed.
" 18. Agreed statement of evidence lodged.
" 20. Agreed statement of evidence approved and filed.
" 21. Order enlarging time to Nov. 30, 1932 *6*o transmit and deliver record entered.

[fol. 30] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

[Title omitted]

PETITION—Filed Dec. 31, 1928

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:AR:RR-60D—JSM), dated November 6, 1928, and as the basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 71 Conti Street, Mobile, Ala.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A" was mailed to petitioner on November 6, 1928.

[fol. 31] 3. The taxes in controversy are income taxes as follows:

Year 1924	$9,690.95
" 1925	15,391.97
" 1926	1,973.31
Total	$27,056.23

4. The determination of tax, as set forth in the said notice of deficiency, is based upon the following errors:

(a) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction listing fees on capital stock in the amount of $2,400.00.

(b) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction expenditures in the amount of $3,283.85 on account of transportation for investment—Credit.

(c) In computing the taxable net income the Commissioner has erroneously disallowed amortization of bond

discount in the amount of $4,585.32 for each of the years 1924, 1925 and 1926.

(d) In computing taxable net income for the years 1925 and 1926 the Commissioner has erroneously included the estimated additional mail pay in the amounts of $4,280.29 and $10,200.58, respectively.

(e) In computing the taxable net income for the year 1926 the Commissioner has erroneously disallowed as a deduction depreciation on Ways and Structures of its subsidiary, the Jackson & Eastern Railway Company, in the amount of $7,374.87.

5. The facts upon which petitioner relies, as the basis of this proceeding, are as follows:

(a) Petitioner is a corporation, organized under the laws of the State of Alabama and other States, with principal office at 71 Conti Street, Mobile, Ala. Ever since organization it has been engaged in the operation of railroads.

(b) In each of the years 1924, 1925 and 1926 petitioner was affiliated with the Meridian & Memphis Railway Company and from August 15th to December 31st, 1926, petitioner was affiliated with the Jackson & Eastern Railway Company.

(c) Petitioner rendered a timely income tax return for the calendar year 1924 (including therein the results of the [fol. 32] operations of the Meridian & Memphis Railway Company) which showed a net income of $1,060,384.95 and a tax liability of $132,548.12. Petitioner rendered a timely income tax return for the calendar year 1925 (including therein the results of the operations of the Meridian & Memphis Railway Company) showing a net income of $1,355,-470.63 and a tax liability of $176,211.18.

Petitioner rendered a timely income tax return for the year 1926 (including therein the operating results of the Meridian & Memphis Railway Company for the entire year 1926 and the Jackson & Eastern Railway Company from August 15th to December 31, 1926) showing a consolidated net income of $1,408,738.06, and a tax liability of $190,-179.64.

(c) In the year 1924 petitioner expended $2,400.00 in connection with listing its stock on the New York Stock Exchange, which amount was deducted on its income tax return as an expense for that year. The Commissioner has disallowed the deduction, which gives rise to the error noted in paragraph 4 (a) above.

(d) During the year 1924 petitioner transported material and supplies, etc., of its own from one point to another over its own line, and for its own use.

Under the Interstate Commerce Commission rules a regular transportation charge must be entered in an account termed "Transportation for Investment-Credit."

The charge for the year 1924 amounted to $3,283.85. The Commissioner has excluded this item from deductible expenses in computing taxable net income, which action gives rise to the error noted in paragraph 4 (b) above.

(e) The Meridian & Memphis Railway Company, a subsidiary of the petitioner, issued and sold its First Mortgage Bonds in the year 1913, at a discount of $131,200.00.

This discount is being amortized over the life of the bonds, in accordance with the method prescribed by the Interstate Commerce Commission. The proportionate part applicable to and deducted in each of the years 1924, 1925 and 1926 was $4,585.32. This amount was deducted in each of the years in arriving at the consolidated net income.

The Commissioner has disallowed the deduction in each year, which action gives rise to the error noted in paragraph 4 (c) above.

(f) On July 10, 1928 the Interstate Commerce Commission entered Order No. 9200 "Railway Mail Pay" in which [fol. 33] common carriers subject to the Act of July 28, 1916 were granted certain retroactive increases in the rates theretofore established for transportation of the U. S. Mails.

The Commissioner has erroneously added the estimated additional mail pay granted under this order to the income for the year 1925, in the amount of $4,280.29 and in the year 1926 in the amount of $10,200.58. This action gives rise to the error noted in paragraph 4 (d) above.

(g) The Jackson & Eastern Railway Company, a subsidiary of the petitioner, charged off on its books deprecia-

tion on Ways and Structures, consisting of bridges, trestles, culverts, rails, roadway buildings, etc., for the period August 15th to December 31, 1926, aggregating $7,374.87.

The Commissioner has erroneously disallowed this deduction, which gives rise to the error noted in paragraph 4 (e) above.

6. Wherefore, petitioner prays that this Board may hear the proceeding and find:

(a) That listing fees in the amount of $2,400.00 were properly deductible in arriving at the net taxable income for the year 1924.

(b) That expenditures in the amount of $3,283.85 in transporting its own material over its own lines for its own use and charged as transportation for investment-credit, on its records, should be allowed as a deduction in computing the taxable net income for the year 1924.

(c) That bond discount on Meridian & Memphis Railway Company First Mortgage Bonds, in the amount of $4,585.32, should be allowed as a deduction in each of the years 1924, 1925 and 1926.

(d) That estimated additional mail pay in the amount of $4,280.29 and $10,200.58 was not taxable income for the years 1925 and 1926, respectively.

(e) That depreciation on Ways and Structures of the Jackson & Eastern Railway Company, in the amount of $7,374.87, should be allowed in computing the net income for the year 1926.

(f) That petitioner's tax liability for the years 1924, 1925 and 1926 should be recomputed on the basis of your find-
[fol. 34] ings and the deficiency or over-payment re-determined on such basis.

And grant such other relief as Petitioner may be entitled to or which to the Board may seem equitable and proper.

Geo. E. H. Goodner, Counsel for Petitioner. Address: Munsey Building, Washington, D. C. Of Counsel: Walter K. Smith, Mobile, Alabama.

Duly sworn to by R. E. De Neefe. Jurat omitted in printing.

EXHIBIT "A" TO PETITION

Treasury Department

Office of Commissioner of Internal Revenue

IT:AR:RR-60D. JSM.

Washington, D. C., Nov. 6, 1928.

Gulf, Mobile and Northern Railroad Company, 71 Conti Street, Mobile, Alabama.

SIRS: In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax [fol. 35] liability for the years 1924, 1925 and 1926, discloses a deficiency of 27,056.23, as shown in the attached statement.

The sections of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter for a redetermination of your tax liability. However, if you acquiesce in this determination, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully, D. H. Blair, Commissioner, (Signed) by C. B. Allen, Deputy Commissioner.

Enclosures: Statement, Form 866, Form 882, Schedules Nos. 1 to 9, inclusive.

IT:AR:RR—60D. JSM.

Statement of Returns Examined and Resulting Tax Liability

Returns Examined

Company	Year	Form
Gulf, Mobile and Northern Railroad Company, Mobile, Alabama	1924	1120
	1925	1120
	1926	1120

Resulting Tax Liability

Company	Year	Tax liability	Deficiency
Gulf, Mobile and Northern Railroad Company, Mobile, Alabama	1924	$142,239.07	$9,690.95
	1925	191,603.15	15,391.97
	1926	192,152.95	1,973.31
Totals		$525,995.17	$27,056.23

The adjustments producing the above-stated results are contained in the attached schedules 1 to 9, inclusive.

[fol. 36] In determining your tax liability as stated herein, careful consideration has been given to the statements contained in your protest dated June 12, 1928, and the additional information submitted at conference held in this office July 23, 1928.

A carbon of this letter has been mailed to each of your representatives, Mr. George E. H. Goodner, Munsey Building, Washington, D. C., and Mr. Walter K. Smith, City Bank Building, Mobile, Alabama, in accordance with your powers of attorney running to them, which are on file in this office.

Schedule 1

Net Income

Net income as disclosed by returns	$1,060,384.95
As corrected	1,137,912.56
Net adjustment	$77,527.61

Unallowable deductions and additional income:

(a) Contributions	$866.67
(b) Listing stock fees	2,400.00
(c) Transportation for investment credit	3,283.85
(e) Repairs	8,428.74
(f) Fines for violation Federal Laws	523.64
(g) Write-down investment in securities	5,677.00
(h) Federal income taxes	45.54
(i) Amortization of bond discount	2,106.72

(j) Meridian and Memphis Railway Company bond discount amortization	4,585.32
(k) Interest during construction, sale of Hattiesburg Branch	35,310.13
(l) Increase in personal injury reserve	14,300.00
Total	$77,527.61

Schedule No. 1-A

Explanation of Items Charged

(a) Contributions are unallowable deductions in accordance with the provisions of Office Decision No. 986, Cumu- [fol. 37] lative Bulletin No. 5, Page 222. Therefore, the following payments during the year 1924 are herein disallowed:

Y. M. C. A., Mobile, Alabama	$300.00
Y. M. C. A., Laurel, Mississippi	166.67
Y. M. C. A., Laurel, Mississippi	400.00
Total	$866.67

(b) This expenditure of $2,400.00 was for the purpose of listing your capital stock on the New York Exchange. In accordance with the provisions of I. T. 1836, C. B. 11-2, page 158, the fee paid by a corporation to a stock exchange for the purpose of listing its stock is considered a capital expenditure and is not deductible as a business expense.

(c) Transportation for investment, credit, $3,283.85.

It is held that amounts credited to Transportation for Investment, Credit, account are not within the purview of Office Decision 811, C. B. 4, page 276, such amounts representing the allocated cost of transporting men and materials in connection with construction work, which had been charged to operating expenses, are capital expenditures. (See also Great Northern Railway Company, 8 B. T. A. 225.)

(e) Amount charged to Suspense Account—General, during the months of July, August, October and November, 1923, for "Repairs" to the Gulf, Mobile and Northern Official Car No. 50, and cleared monthly from this account beginning in 1924, and charged to Maintenance of Equip-

ment—Account #326, for the reason that having determined that the cost of such repairs did not constitute the major portion of the value as renewed, therefore, the cost represents an operating expense.

This expense was cleared over a period of eleven months, commencing from October, 1924, to and including the month of August, 1925, at the rate of $2,809.57, per month and as the cost of repairing this car is applicable to the year 1923, the deduction taken in 1924 and 1925 is disallowed in accordance with Article 112, Regulations 65.

Prorated over period October 1 to December 31, 1924	$8,428.74
Prorated over period January 1 to December 31, 1925	22,476.56
Total	$30,905.30

[fol. 38] (f) Fines for violation of Federal Laws are not ordinary and necessary expenses of operation under Section 214 of the Revenue Act of 1924. Deduction of $523.64, is therefore disallowed (Great Northern Railway Company case, 8 B. T. A., page 225).

(g) Loss claimed on investments in stock and bonds is not deductible since the securities have not been proven worthless, or disposed of:

Mississippi Export Railroad Company stock	$2,434.00
Jackson and Eastern Railway Company bonds	3,243.00
Totals	$5,677.00

(h) Federal income taxes of $136,045.54 are included in your "Railway Tax Accruals" account. Since $136,000.00 has been treated as an unallowable deduction on your return, the difference, of $45.54, is now added back to taxable income.

(i) The amount of $2,106.72 is debt discount or expense extinguished through surplus applicable to prior years and, therefore, not deductible for the current year.

(j) The Meridian and Memphis Railway Company was affiliated with your corporation during the years 1924, 1925 and 1926 and included in the consolidated return. The

bonds were intercompany obligations, which fact is conceded by you. Under the decision of the Board of Tax Appeals in the case of the New Orleans, Texas and Mexico Railroad Company, 6 B. T. A., page 436, the Commissioner was sustained on a similar adjustment.

Amortization of discount on funded debt by the Meridian and Memphis Railroad Company in the amount of $4,585.32 is, therefore, disallowed as a deduction.

(k) It is noted that an estimated value was used in the determination of the loss on the sale during the year 1924 of the Hattiesburg branch. Since such estimated value included $35,310.13 as interest during construction, this amount is disallowed as a deduction.

(l) This amount is disallowed for the reason that it represents a reserve for anticipated losses resulting from personal injury. According to information submitted with your letter of July 26, 1928, the following net credits were made to the "Personal Injury Reserve" *ac* account during the years indicated:

[fol. 39]

Year	Account
1923	$47,200.00
1924	14,300.00
1925	88,500.00
1926	(5,190.00)

Schedule 2

Consolidated Reconciliation of Surplus

Surplus at beginning of year:	
Gulf, Mobile and Northern Railroad Company	$3,675,548.01
Meridian and Memphis Railway Company (deficit)	(363,828.87)
Consolidated surplus at beginning of year	$3,311,719.14
Net income as corrected, Schedule 1	1,137,912.56

Nontaxable Income:		
Donations		7,185.95
Interest during construction		1,890.24
Interest during construction (prior years)		18,913.66
Capital account charged with deep well		2,824.03
Obsolescence of Blodgett branch		44,794.45
Total		4,525,240.03
Amount brought forward		$4,525,240.03
Unallowable deductions:		
Contributions	$866.67	
Listing stock fees	2,400.00	
Repairs	8,428.74	
Fines for violation Federal Laws	523.64	
Write-down of investments	5,677.00	
Federal income taxes	136,045.54	
Amortization bond discount	2,106.72	
Dividends	713,000.00	
Meridian and Memphis Bond discount amortization	4,585.32	
Interest during construction on Hattiesburg branch	35,310.13	
[fol. 40] Increase in personal injury reserve	14,300.00	
Total, deduct from above		923,243.76
Balance, surplus at end of the taxable year		$3,601,996.27
Surplus at end of year 1924:		
Gulf, Mobile and Northern Railroad Company		$3,970,446.55
Meridian and Memphis Railway Company (deficit)		(368,450.28)
Consolidated surplus at the end of year		$3,601,996.27

Schedule 3

Computation of Taxes, 1924 Rates

Net Income	$1,137,912.56
Income tax at 12½%	142,239.07
Taxes previously assessed	132,548.12
Additional tax to be assessed	$9,690.95

Gulf, Mobile and Northern Railroad Company

Year Ended December 31, 1925

Schedule 4

Net Income

Net income as disclosed by return	$1,355,470.63
As corrected	1,473,870.42
Net adjustment	$118,399.79

[fol. 41] Unallowable deductions and additional income:

(a) Contributions	$1,600.00
(c) Loss on retired road	2,824.03
(d) Repairs	22,476.56
(e) Transportation for investment, Cr.	77.48
(f) Write-down in value of investments	2,751.00
(g) Meridian and Memphis Railway Company bond discount amortization	4,585.32
(h) Increase in personal injury reserves	88,500.00
(i) Additional mail pay	4,280.29
Total additions	$134,094.68
Nontaxable income and additional deductions:	
(j) Unamortized expense, Series "A" bonds	15,694.89
Net adjustment as above	$118,399.79

Schedule 4-A

Explanation of Items Changed

(a) Contributions are unallowable deductions. See Item (a), Schedule 1 (a).

Donations to Firemen	$100.00
Y. M. C. A. contributions	1,500.00
Total	1,600.00

(c) It is noted that you have included in the charge to profit and loss for loss on retired road an amount of $2,824.03, on account of the abandonment of a deep well at Louisville, Mississippi. Since the capitalization of this amount in 1924 was treated as non-taxable income, the deduction against gross income in 1925 is disallowed.

(d) See item (e), Schedule No. 1-A.

(e) See Item (c), Schedule No. 1-A.

(f) Miscellaneous debits, $9,751.00.

[fol. 42] The *right*-down in value of securities held by your company can not be considered an allowable deduction in view of the provisions of Article 144, Regulations 65:

Adjustments as follows are, therefore disallowed:

Write-down in value of Mississippi Export Railroad Company stock	$5,258.00
Write-down in value of Jackson and Eastern Railway Company bonds	4,493.00
Total	$9,751.00

(g) See item (j) Schedule 1-A.

(h) The amount set up in anticipation of personal injury claims as an unadjusted credit—Suspense Account General—$88,500.00, is added to taxable income for the reason that the deduction taken is not applicable to the year 1925 (Article 112, Regulations 65).

(i) On July 10, 1928, the Interstate Commerce Commission entered Order No. 9200, "Railway Mail Pay," in which common carriers subject to the Act of July 28, 1916, were granted certain retroactive increases in the rates theretofore established for transportation of the United States

Mails. In accordance with the reasoning adopted by the United States Board of Tax Appeals, in the case of the Western Maryland Railway Company, Docket No. 6475, with respect to the issue of railway mail pay, the amount of $4,280.29 representing the additional railway mail pay reported in your letter dated September 27, 1928, is included in your taxable income for the year 1925.

(j) Unamortized expense, Series "A" bonds, $12,042.38.

In accordance with the provisions of General Counsel Memorandum #3832, C. B. V11—22, page 3, on the subject of amortization of bond discount and expense, the expenses of Series "A" bonds should be amortized through the years 1920 to 1925, and any unamortized balance remaining when the bonds were prematurely retired would be deductible in the year of retirement. Accordingly, the following adjustment appears to be in order and has been made.

Expense sustained		$19,446.73
Date of issue: October 1, 1920.		
Date of maturity: October 1, 1950.		
[fol. 43] Chargeable:		
1920	$162.06	
1921	648.22	
1922	648.22	
1923	648.22	
1924	648.24	
		2,754.96
Balance allowable in 1925		$16,691.77
Amount deducted on return	$4,549.39	
Deductible, Series B bonds	3,552.51	
Difference, deduct from above		996.88
Additional deduction allowable		$15,694.89

Schedule 5

Consolidated Reconciliation of Surplus

Surplus at beginning of year:		
Gulf, Mobile and Northern Railroad Company		$3,970,446.55
Meridian and Memphis Railway Company (deficit)		368,450.28
Consolidated surplus at beginning of year		$3,601,996.27
Net income as corrected, Schedule # 4		1,473,870.42
Nontaxable income:		
Donations		8,640.42
Income on Government Securities		20,247.14
Interest during construction		13.17
Obsolescence of Blodgett branch		44,794.45
Unamortized expense, Series "A" bonds		15,694.89
Total		$5,175,256.76
Unallowable deductions:		
Additional mail pay	$4,280.29	
Contributions	1,600.00	
Dividends	998,788.50	
[fol. 44] Income taxes	174,000.00	
Loss on retired road	2,824.03	
Repairs	22,476.56	
Miscellaneous debits	9,751.00	
Meridian and Memphis bond discount	4,585.32	
Personal injury reserve increase	88,500.00	
Total deduct from above		1,306,805.70
Balance		$3,868,451.06

Surplus at end of year:	
Gulf, Mobile and Northern Railroad Company	4,241,486.66
Meridian and Memphis Railway Company (defict)	373,035.60
Consolidated surplus at end of year	$3,868,451.06

Schedule 6

Computation of Taxes, 1925 Rates

Net income taxable year, Schedule 4	$1,473,870.42
Income tax at 13%	191,603.15
Taxes previously assessed	176,211.18
Additional tax to be assessed	$15,391.97

Gulf, Mobile and Northern Railroad Company

Year Ended December 31, 1926

Schedule 7

Net Income

Net income as disclosed by return	$1,408,738.06
As corrected	1,423,355.17
Net adjustment	$14,617.11

[fol. 45] Unallowable deductions and additional income:

Gulf, Mobile and Northern R. R. Company:		
(a) Contributions	$750.00	
(c) Write-down value of securities	3,248.00	
(d) Amortization expense, Series "A" bonds	632.69	
(e) Excessive loss on sale reported	225.00	

(f) Additional mail pay	9,747.42	
Meridian and Memphis Railway Company:		
(g) Bond discount	4,585.32	
Jackson and Eastern Railway Company:		
(i) Federal income taxes	600.00	
(j) Depreciation on way and structures	7,374.87	
(k) Additional mail pay	453.16	
Total additions		27,616.46
Nontaxable income and additional deductions:		
Gulf, Mobile and Northern Railroad Company:		
(l) Adjustment value Jackson and Eastern bonds	7,736.00	
(m) Decrease in Personal Injury reserve	5,190.00	
(n) Amortization of bond discount	73.35	
Total deductions		12,999.35
Net adjustment as shown above		$14,617.11

Schedule 7-A

Explanation of Items Changed

(a) See Schedule 1-A, item (a).

[fol. 46] (c) Reduction in the book value of investment in securities is not deductible for the reason that the securities have not been proven worthless or disposed of. Article 144, Regulations 69.

(d) Amortization of expense, Series "A" bonds, $632.69.

Since the unamortized expenses on series "A" bonds has been allowed as a deduction from gross income in the year of retirement and cancellation (1925), the amount $632.69, taken as a deduction during the year 1926 is disallowed:

Deduction allowable B bonds	$5,482.03
Deduction taken on return	6,114.72
	$632.69

(e) Loss on sale of 77 acres of land at Ellisville, Mississippi, purchased at $8.00 per acre:

Cost	$616.00
Sale price (A. F. E. 1841)	225.00
Loss sustained	$391.00

Since a charge of $616.00 was included in your miscellaneous debits on account of the above transaction, the loss on sale reported in excess of the actual loss sustained is disallowed.

(f) On July 10, 1928, the Interstate Commerce Commission entered order No. 9200, "Railway Mail Pay," in which common carriers subject to the Act of July 28, 1916, were granted certain retroactive increases in the rates theretofore established for the transportation of the United States Mails. In accordance with the reasoning adopted by the United States Board of Tax Appeals, in the case of the Western Maryland Railway Company, Docket No. 6475, with respect to the issue of Railway Mail Pay, the amount $9,747.42 representing the additional Railway Mail Pay reported in your letter dated September 27, 1928, is included in your taxable income for the year 1926.

(g) See explanation under item (j), Schedule 1-A.

(i) See item (f) amount applicable to period August 16, to December 31, 1926.

(j) Federal income taxes are unallowable deductions in accordance with the provisions of Article 131, Regulations 69.

[fol. 47] (k) Depreciation on way and structures is held to be an unallowable deduction from gross income in accordance with Treasury Decision 3125. Since this point is on appeal by the Jackson and Eastern Railway Company for prior years, deduction thereof is disallowed.

(l) Write-up in books value of securities held by your corporation is non taxable income. Since the write-down in value during the years 1924 and 1925 was charged to

profit and loss as a miscellaneous debit and has been disallowed as a deduction in the audit of prior years, adjustment is now made for the amount restored in the valuation of Jackson and Eastern Railway Company's bonds held by your corporation.

(m) Inasmuch as the amount set up in anticipation of personal injury claims was disallowed in the audit of the year 1925, the charges to the suspense account of claims paid during the year 1926 are hereby allowed as deductions.

(n) In the spread of discount and expenses of $750.00 sustained in connection with the issue of $30,000.00 obligations of the Jackson and Eastern Railway Company, the amount of $73.35 is an allowable reduction for the period August 16, to December 31, 1926:

Period	Amortization allowable
March 20, 1926 to August 15, 1926	$73.35
August 16, 1926 to December 31, 1926	73.35
Year 1927	195.65
1928	195.65
1929	195.65
1930	16.35
total	$750.00

[fol. 48]

Schedule 8

Consolidated Reconciliation of Surplus

Surplus at beginning of year:	
Gulf, Mobile and Northern Railroad Company	$4,241,486.66
Meridian and Memphis Railway Company (deficit)	(373,035.60)
Jackson and Eastern Railway Company, August 15, 1926	62,271.15
Consolidated surplus at beginning of year	$3,930,722.21
Net income as corrected, Schedule 7	$1,423,355.17

Nontaxable income:		
Donations		$20,288.03
Income from Government Securities		37,572.22
Interest during construction		2,191.25
Jackson and Eastern Railway Company amortization of bond discount		73.35
Personal injury reserve reduction		5,190.00
Book value adjustment of investment in securities		7,736.00
Obsolescence of Blodgett branch		44,794.45
Total		$5,471,922.68
Unallowable deductions:		
Contributions	$750.00	
Write-down book value of stock	3,248.00	
Loss on sale reported, excessive	225.00	
M. and M. bond discount, intercompany	4,585.32	
Federal income taxes	193,687.63	
Jackson and Eastern income taxes	600.00	
Dividends	970,260.00	
Depreciation of Way and Structures	7,374.87	
[fol. 49] Amortization expense, Series "A"	632.69	
Additional mail pay	10,200.58	
Total, deduct from above		1,191,514.09
Balance, surplus at end of year		$4,280,358.59
Surplus at end of taxable year 1926:		
Gulf, Mobile and Northern Railroad Company		4,598,683.91
Meridian and Memphis Railway Company (deficit)		(373,080.66)
Jackson and Eastern Railway Company		54,755.34
Total as above		$4,280,358.59

Schedule 9

Computation of Taxes, 1926 Rates

Net income taxable year, Schedule 7	$1,423,355.17
Income tax at 13½%	192,152.95
Taxes previously assessed, Account #40658	190,179.64
Additional tax to be assessed	$1,973.31

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

[Title omitted]

ANSWER—Filed March 2, 1929

Comes now the Commissioner of Internal Revenue, by his attorney C. M. Charest, General Counsel, Bureau of [fol. 50] Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (e), incl. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph 4 of the petition.

5. (a) to (g), incl. Denies the allegations contained in subparagraphs (a) to (g), inclusive, of paragraph 5 of the petition.

Denies each and every other allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore it is prayed that the Commissioner's determination be approved and that the petition be dismissed and the appeal denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: A. H. Fast, Special Attorney, Bureau of Internal Revenue.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.

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22 B. T. A., —

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887, 35898, 38295, 42149, 42150

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

[fols. 51 & 52] JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

MERIDIAN & MEMPHIS RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

FINDINGS OF FACT AND OPINION—Promulgated February 20, 1931

George E. H. Goodner, Esq., and Walter K. Smith, Esq., for the petitioners.

E. C. Algire, Esq., for the respondent.

These proceedings have been consolidated for hearing and decision. The respondent has determined deficiencies in income taxes, for the years and in the amounts, as follows:

Petitioner	Docket No.	Year	Deficiency
Gulf, Mobile & Northern Railroad Co.....	24887	1920	$14,731.74
Gulf, Mobile & Northern Railroad Co.....	42150	1924	9,690.95
		1925	15,391.97
		1926	1,973.31
Jackson & Eastern Railway Company.....	38295	1923	2,145.55
		1924	1,275.53
		1925	4,030.04
Jackson & Eastern Railway Company.....	42149	1926	1,838.02
Meridian & Memphis Railway Company....	35898	1922	2,603.29

[fol. 53]

Docket No. 42150

The petitioner, Gulf, Mobile & Northern, makes six assignments of error, one of which is admitted by the respondent, leaving the following for decision by the Board:

(a) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction listing fees on capital stock in the amount of $2,400.

(b) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction expenditures in the amount of $3,283.85 on account of transportation for investment—Credit.

(c) In computing the taxable net income the Commissioner has erroneously disallowed amortization of bond discount in the amount of $4,585.32 for each of the years 1924, 1925 and 1926.

(e) In computing the taxable net income for the year 1926 the Commissioner has erroneously disallowed as a [fols. 54 & 55] deduction depreciation on ways and structures of its subsidiary, the Jackson & Eastern Railway Company, in the amount of $7,374.87.

(f) In computing taxable net income for the years 1924, 1925 and 1926 the Commissioner has erroneously disallowed as deductions amounts paid to Young Men's Christian Associations located at division points on petitioner's railway system in the amounts of $866.67, $1,500 and $750 for the respective years aforesaid.

The one assignment of error admitted by the respondent is as follows:

(d) In computing taxable net income for the years 1925 and 1926 the Commissioner has erroneously included the estimated additional mail pay in the amounts of $4,280.29 and $10,200.58 respectively.

[fols. 56-60] Findings of Fact

The petitioner, Gulf, Mobile & Northern, is an Alabama corporation with its principal office at 71 Conti Street, Mobile, Alabama.

The petitioner, Jackson & Eastern, is a Mississippi corporation with its principal office at 71 Conti Street, Mobile, Alabama. All of the capital stock of this company was acquired by the Gulf, Mobile & Northern, on August 15, 1926.

The petitioner, Meridian & Memphis, is a Mississippi corporation with its principal office at 71 Conti Street, Mobile, Alabama. It is a subsidiary of the Gulf, Mobile & Northern.

The Gulf, Mobile & Northern and the Meridian & Memphis filed consolidated returns for 1920, 1921, 1922, 1924 and 1926. A single consolidated return was filed by these three petitioners, for 1926, in which there was included the income of the Jackson & Eastern for the period August 16 to December 31, 1926.

[fols. 61–65] Amortization of Bond Discount

Issue (c), Docket 42150

At various dates between 1913 and 1916, the Meridian & Memphis sold its 30-year 5 per cent gold bonds, of a total face value of $675,000, to the Equitable Loan & Mortgage Company of Mobile, at a discount of approximately $131,000. At the time the Gulf, Mobile & Northern acquired the capital stock of the Meridian & Memphis, the bonds of the latter were pledged as collateral for certain collateral trust notes of the Equitable Loan & Mortgage Company. These notes fell due during the period of federal control and were taken up by the War Finance Corporation. At the end of federal control the Gulf, Mobile & Northern settled with the War Finance Corporation for the notes, and took over the bonds pledged as collateral thereto, at a cost of $636,000. Each year, the Meridian & Memphis has charged off on its books 1/30th of the discount on its bonds, and in its returns for 1924, 1925 and 1926, claimed deductions for amortization of bond discount, each in the amount of $4,585.32. These deductions have been disallowed by the respondent in determining consolidated net income.

[fols. 66-87] OPINION.

TRAMMELL:

[fols. 88-95] Amortization of Bond Discount

Issue (c), Docket 42150

The question whether a corporate taxpayer, having issued its bonds for a price less than their aggregate face value, may deduct a pro rata part of the discount, in computing consolidated net income for a year in which such bonds were owned by its affiliated company, has been decided by the Board, in New Orleans, Texas & Mexico Railway Company, 6 B. T. A. 436, adversely to the petitioner; and upon authority of that decision, we hold that the respondent, in computing the consolidated net income for 1924, 1925 and 1926, correctly disallowed the deductions claimed by the Meridian & Memphis for amortization of bond discount.

[fol. 96] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

[fol. 97] Docket Nos. 38295 and 42149

JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 35898

MERIDAN & MEMPHIS RAILWAY CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

These proceedings came on to be heard in Washington, D. C., on September 23, 1931, pursuant to notice under Rule

50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated February 20, 1931, as modified by order this day entered, and, it appearing that the Gulf, Mobile and Northern Railroad Company had paid $14,161.44 of the tax for 1920 shown to have been assessed in the deficiency letter, and it further appearing that the net income of the Meridian and Memphis for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern and the Meridian and Memphis Railway for 1922 was $738,283.85, after deducting the 1921 consolidated net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2,307.63 represents the liability of the Meridian and Memphis when apportioned according to the respective incomes of the two companies, and it appearing further that the Jackson & Eastern sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed and stipulated the deficiencies, overassessments, and overpayments hereinafter set out, it is hereby

Ordered and decided that the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

[fol. 98] Gulf, Mobile & Northern Railroad Co.:	
1920 deficiency	$711.97
1920 overassessment to be abated	8,022.86
1924 deficiency	9,582.62
1925 deficiency	14,640.54
1926 overassessment and overpayment	505.01
Meridian & Memphis Railway Co.:	
1922 deficiency	2,307.63
Jackson & Eastern Railway Co.:	
1923 overassessment and overpayment	101.37
1924 no deficiency	.....
1925 deficiency	1,176.18
1926 deficiency	91.72

(Signed) Charles M. Trammell, Member.

Entered Sept. 30, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

(Seal U. S. Board of Tax Appeals.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 38295 and 42149

JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 35898

MERIDIAN & MEMPHIS RAILWAY CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

REVISED DECISION

On motion of counsel for petitioners, agreed to by counsel for respondent, it is hereby

[fol. 99] Ordered and decided that the decision entered September 30, 1931, is hereby set aside and vacated and the following decision entered herein:

These proceedings came on to be heard in Washington, D. C., on September 23, 1931, pursuant to notice under Rule 50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated February 20, 1931, as modified by order that day entered, and it appearing that the Commissioner of Internal Revenue in February, 1924, assessed a tax of $22,896.27 against the Gulf, Mobile & Northern Railroad Company for 1920, of which $14,161.44 has been paid, and that the correct tax liability for said year is $14,873.41; and it further appearing that the net income of the Meridian and Memphis Railway Company for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern Railroad Company and the Meridian and Memphis Railway Company for 1922 was $738,283.85, after deducting the 1921 consolidated

net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2307.63 represents the liability of the Meridian and Memphis Railway Company when apportioned according to the respective incomes of the two companies, and it appearing further that the Jackson & Eastern Railway Company sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed that the deficiencies, overassessments, and overpayments hereinafter set out are in accordance with the Board's findings and opinion, it is hereby

Ordered and decided that the unpaid assessments to be collected, the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

	Gulf, Mobile & Northern Railroad Co.:	
1920	Unpaid assessment to be collected	$711.97
1920	Overassessment to be abated	8,022,86
1924	Deficiency	9,582.62
1925	Deficiency	14,640.54
1926	Overassessment and overpayment	505.01
[fol. 100]	Meridian & Memphis Railway Co.:	
1922	Deficiency	2,307.63
	Jackson & Eastern Railway Co.:	
1923	Overassessment and overpayment	101.37
1924	No deficiency	.....
1925	Deficiency	1,176.18
1926	Deficiency	91.72

(Signed) C. M. Trammell, Member.

Entered Nov. 7, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

[Stamp:] Received Dec. 4, 1931, U. S. Board of Tax Appeals.

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Dockets 24887 and 42150, Docket 35898, Dockets 38295 and 42149

[Title omitted]

MOTION TO SET ASIDE FINAL DECISION, ETC.—Filed Dec. 4, 1931

Comes now the respondent, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and moves that the Board set aside its final decision entered in these appeals on November 7, 1931, and that it reconsider its decision promulgated February 20, 1931, with respect to the issue involving the question of whether or not the amount received by the petitioner, Gulf, Mobile & Northern Railroad Company, during the year 1920 as additional compen-
[fol. 101] sation for the transportation of United States mails pursuant to the award of the Interstate Commerce Commission rendered in "Railway Mail Pay," 56 I. C. C. 1, in view of the Board's decision in the case of the International-Great Northern Railroad Company v. Commissioner of Internal Revenue, promulgated November 11, 1921, with respect to a similar question wherein the Board specifically overruled its decision on this issue in the instant case.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: E. C. Algire, Special Attorney, Bureau of Internal Revenue.

ECA: RBI.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No-. 24887, 35898, 38295, 42149, 42150

[Title omitted]

ORDER GRANTING MOTION TO SET ASIDE FINAL DECISION, ETC.

This cause coming on to be heard upon the motion of the respondent to set aside the final decision entered in these proceedings on November 7, 1931, and to reconsider its decision promulgated February 20, 1931, with respect to the issue involving the question whether or not the amount received by the petitioner Gulf, Mobile & Northern Railroad
[fol. 102] Company during 1920 as additional compensa-

tion for the transportation of United States Mails pursuant to the award of the Interstate Commerce Commission, and it appearing that the decision of the Board in this proceeding with respect to that issue has been overruled by a subsequent decision of the Board in the case of International-Great Northern Railroad Company v. Commissioner of Internal Revenue, promulgated November 11, 1931, and after having heard the argument of counsel, and being fully advised in the premises, it is

Ordered that the motion be and the same is hereby granted. It is

Further ordered that the decision of the Board entered in these proceedings on November 7, 1931, be and the same is hereby modified in this respect. It is

Further ordered that the additional compensation for the transportation of United States mails received by the Gulf, Mobile & Northern Railroad Company in 1920 should be included in the taxable income for that year. It is

Further ordered that the amount of deficiency for 1920 be recomputed accordingly, and that the income for 1919 be reduced accordingly.

(Signed) Charles M. Trammell, Member United States Board of Tax Appeals.

b.

Entered Dec. 19, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket Nos. 24887, 42150

[Titles omitted]

[fol. 103] Docket Nos. 38295, 42149

Docket No. 35898.

ORDER MAKING OBJECTION AND EXCEPTION A MATTER OF RECORD

Whereas, an order heretofore entered in the above-entitled proceeding on December 19, 1931, wherein the previous findings of fact and opinion of the Board were amended so as to include in income for 1920 certain Railway Mail pay

over objection of counsel for the petitioner; and whereas counsel for petitioner objected of record and asked that the record show an exception; and whereas through inadvertence said order did not recite the objection and exception of petitioner, it is, therefore,

Ordered: That the objection and exception to said order be made a matter of record.

Signed) Charles M. Trammell, Member.

Dated Washington, D. C., December 21, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

Before United States Board of Tax Appeals, Washington

Docket Nos. 24887, 42150

Gulf, Mobile & Northern Railroad Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

[fol. 104] Docket Nos. 38295, 42149

Jackson & Eastern Railway Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Docket No. 35898

Meridian & Memphis Railway Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Second Revised Decision

Pursuant to order of the Board entered December 19, 1931, and petitioners' motion for settlement this day filed, which motion is agreed to by respondent, it is hereby

Ordered and decided that the Revised decision entered November 7, 1931, is hereby set aside and vacated and the following decision is entered herein:

These proceedings came on to be heard in Washington, D. C., on this day, pursuant to notice under Rule 50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated Feb-

ruary 20, 1931, as modified by orders entered September 30, 1931, and December 19, 1931, and it appearing that the Commissioner of Internal Revenue in February, 1924, assessed a tax of $22,896.27 against the Gulf, Mobile and Northern Railroad Company for 1920, of which $14,161.44 has been paid, and that the correct tax liability for said year is $15,273.41; and it further appearing that the net income of the Meridian and Memphis Railway Company for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern Railroad Company and the Meridian and Memphis Railway Company for 1922 was $738,283.85, after deducting the 1921 consolidated net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2,307.63 represents the liability of the Meridian and Memphis Railway Company when apportioned according to the respective incomes of the two companies; and it appearing [fol. 105] further that the Jackson & Eastern Railway Company sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed that the deficiencies, overassessments, and overpayments hereinafter set out are in accordance with the Board's findings and opinion, it is hereby

Ordered and decided that the unpaid assessments to be collected, the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

	Gulf, Mobile & Northern Railroad Co.:	
1920	Unpaid assessment to be collected	$1,111.97
1920	Overassessment to be abated	7,622.86
1924	Deficiency	9,582.62
1925	Deficiency	14,640.54
1926	Overassessment and overpayment	505.01
	Meridian & Memphis Railway Co.:	
1922	Deficiency	2,307.63
	Jackson & Eastern Railway Co.:	
1923	Overassessment and overpayment	101.37
1924	No deficiency	
1925	Deficiency	1,176.18
1926	Deficiency	91.72

Signed) Charles M. Trammell, Member.

Entered Jan. 25, 1932.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

[fol. 106] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887, 42150

[Title omitted]

STIPULATION FOR COURT OF REVIEW—Filed July 25, 1932

It is hereby agreed and stipulated, by and between counsel for the respective parties, that a review of the decision and order of the United States Board of Tax Appeals in the above designated proceedings may be had before the Court of Appeals of the District of Columbia in accordance with the statutes made and provided, and regulations issued pursuant thereto.

(Signed) Geo. E. H. Goodner, Counsel for Petitioner. C. M. Charest, General Counsel, Bureau of Internal Revenue, Counsel for Respondent.

[File endorsement omitted]

IN THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

Board of Tax Appeals Docket Nos. 24887, 42150

[Title omitted]

PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS—Filed July 25, 1932

To the Honorable Chief Justice and the Associate Justices of the Court of Appeals of the District of Columbia:

Your appellant respectfully represents to the Court:

I. Jurisdiction

1. The Gulf, Mobile & Northern Railroad Company, appellant, is a corporation organized January 1, 1917, under

[fol. 107] the laws of the State of Alabama, and with principal office at 71 Conti Street, Mobile, Alabama. It succeeded another company of the same name which operated its properties as far back as 1907. Ever since organization it has been engaged in the operation of railroads. One of its subsidiary companies is the Meridian & Memphis Railway Company, a corporation organized under the laws of the State of Mississippi in 1911.

2. Appellee is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States.

3. Appellant heretofore appealed to the United States Board of Tax Appeals from letter of the Commissioner of Internal Revenue dated January 6, 1927, wherein the latter notified appellant of a proposed assessment against it of $14,731.74, representing alleged unpaid income taxes for the year 1920; also letter from said Commissioner dated November 6, 1928 notifying appellant of a proposed assessment against it of $27,056.23, representing alleged unpaid income taxes for the years 1924, 1925 and 1926. Said proceedings were given Docket Nos. 24887 and 42150 respectively by the Board.

On February 20, 1931 the Board promulgated its Findings of Fact and Opinion, as modified by Orders entered September 30, 1931 and December 19, 1931, and on January 25, 1932 entered its final Decision wherein it held that appellant's correct tax liability for 1920 was $15,273.41, of which $14,161.44 has been paid, leaving the sum of $1,111.97 as an unpaid assessment for the said year, and further entered that there was a deficiency for 1924 of $9,582.62, a deficiency for 1925 of $14,640.54 and an overassessment and overpayment for 1926 of $505.01.

4. Appellant desires a review by this Court of the Board's findings, opinion and decision on the issues as set out below and brings this action under the provisions of Section 1001, 1002 and 1003, of the Revenue Act of 1926, as amended by Section 603 of the Revenue Act of 1928.

II. Nature of the Controversy

1. From prior to December 31, 1917 to date, the Gulf, Mobile and Northern Railroad Company owned all the stock of the Meridian & Memphis Railway Company, and the two companies were affiliated for income tax purposes

[fol. 108] throughout the years involved in this proceeding. Consolidated returns were filed for the years 1920 to 1926 inclusive.

2. Appellant's railroad and equipment were taken over by the President of the United States, and were under control of the Director General of Railroads throughout the period from January 1, 1918 to February 29, 1920, inclusive. They were turned back to appellant at midnight on February 29, 1920, under the terms of Section 209 of the Transportation Act of 1920.

There was no written "standard agreement" between appellant and the Government in respect to Federal Control of its properties. After appellant's properties were returned to it on February 29, 1920, appellant and the Director General made a final settlement, as a result of which appellant paid to the Director General the sum of $100,000.00, which was in full of all charges against appellant.

Among the properties taken over by the President on December 31, 1917, were material and supplies which had cost appellant $286,664.26. The Director General turned back to appellant at the end of the control period material and supplies, the cost to him and the value of which was $275,912.03. In the aforesaid final settlement, petitioner was allowed the sum of $61,314.18 on its claim that the inventory of material and supplies turned back to it by the Director General was not equal in kind, grade and quality to the inventory of material and supplies which it turned over at the beginning of the period.

In computing the appellant's net income for 1920 appellee has included therein the sum of $50,561.95, arrived at by taking from the sum of the inventory of material and supplies turned back plus the amount allowed appellant in the final settlement, the amount of the original inventory.

When the President took over appellant's properties as of December 31, 1917, an entry was made on appellant's books charging the United States with $286,664.26, the cost of material and supplies. This entry stood until after the final settlement with the Director General, when it was cleared in 1920, with all the other accounts entered into said settlement, through the profit and loss account. This charge to the United States was not an account receivable, but was a memorandum charge, because appellant expected

[fol. 109] to have the material and supplies returned in kind, grade, and quality as the law provided.

Appellant contends that such transaction does not give rise to taxable income, because there was no sale or other disposition of property to the United States and that which was received was not more than sufficient to make it whole against the differences resulting from government control and operation of the properties.

3. In 1920 the Postmaster General paid to appellant the sum of $15,706.62 as additional compensation for carrying the mails in 1916 and 1917, under order of the Interstate Commerce Commission, Case No. 9200. Appellee has included $4,000.00 of this amount in 1920 income as determined by him. Appellant keeps its books on the accrual basis and contends that no part of said compensation for 1916 and 1917 constituted taxable income in 1920.

4. From 1913 to 1916, inclusive, appellant's subsidiary, the Meridian & Memphis Railway Company sold its bonds at a discount, and under the Interstate Commerce Commission rules it set up on its books the amount of the discount as a deferred charge to be amortized over the remaining life of the bonds. It has consistently written off each year the applicable part of said discount, and in the years 1924, 1925 and 1926 it wrote off $4,585.32 in each year, and that amount was claimed as a deduction in the consolidated tax returns for those years.

Appellee has disallowed the deduction on the ground that the bonds are intercompany obligations. Appellant contends that the deduction of the bond discount is not an intercompany transaction. The discount was a deferred charge incurred and entered on the books of the Meridian & Memphis Railway Co. before it became affiliated with the Gulf, Mobile & Northern Railroad Co., and before the latter acquired its bonds, and therefore is a proper deduction in computing income.

III. Assignments of Error

Petitioner as a basis for review makes the following assignments of error:

1. The Board of Tax Appeals erred in sustaining appellee's determination that there was a gain of $50,561.95 as

the amount returned to appellant for material and supplies [fol. 110] at the end of the Federal Control period, in excess of the amount of material and supplies taken over by the Director General at the beginning of the Federal Control period, the Board having failed to find that there was any evidence upon which it could base a conclusion as to the actual gain.

2. The Board of Tax Appeals erred in holding in its order dated December 19, 1931, that the additional compensation for the transportation of United States mails received by appellant in 1920, should be included in taxable income for that year.

3. The Board of Tax Appeals erred in holding that appellee correctly disallowed as a deduction the Meridian & Memphis Railway Co. bond discount of $4,585.32 for each of the years 1924, 1925 and 1926, in computing the consolidated net income of appellant and its subsidiary for those years.

4. The Board of Tax Appeals erred in determining that there was an unpaid assessment of $1,111.97 to be collected for the year 1920.

5. The Board of Tax Appeals erred in its determination of the amount of deficiencies for the years 1924 and 1925, and in its determination of the amount of the overassessment and overpayment for the year 1926.

Wherefore Appellant prays that this Honorable Court will review the said findings, opinion and decision of the Board of Tax Appeals, and reverse and set aside same insofar as the aforesaid assignments of error apply, and therein find for appellant, and grant such other and further relief as appellant may be entitled to or which to the Court may seem equitable and proper, including judgment for costs in this case.

Geo. E. H. Goodner, Attorney for Appellant. Address: Munsey Building, Washington, D. C. Josephus C. Trimble, of Counsel.

Duly sworn to by Josephus C. Trimble. Jurat omitted in printing.

[fol. 111] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Statement of Evidence—Lodged Oct. 18, 1932; Filed Oct. 20, 1932

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable Charles M. Trammel, Member of the United States Board of Tax Appeals, on April 2, 1930. George E. H. Goodner and Walter K. Smith appeared for the petitioner, and C. M. Charest, General Counsel, Bureau of Internal Revenue, appeared for the respondent.

Counsel for the petitioner moved that the appeals of the Gulf, Mobile & Northern Railroad Company, Dockets No. 24887, and 42150, the appeal of Meridian & Memphis Railway Company, Docket No. 35898, and the appeals of Jackson & Eastern Railway Company, Dockets Nos. 38295 and 42149, be consolidated for hearing. No objection was offered to this motion by counsel for respondent and the motion was granted by the Board.

The parties thereupon stipulated that petitioner and the other corporations involved in the consolidated proceeding [fols. 112–118] kept books and rendered income tax returns on the accrual basis of accounting.

MR. F. M. HICKS, a witness on behalf of Petitioner, testified on Direct Examination as follows:

My name is F. M. Hicks. I am 36 years old, and reside at Mobile, Alabama. I am Vice President of the Gulf, Mobile & Northern Railroad Company and have been such since 1925. I came to the Gulf, Mobile & Northern Railroad Company in March, 1919, as Corporate Auditor, which

position I held until the end of Federal Control when I was made Comptroller. I held that position until July 1, 1923, when I was made Traffic Manager and then followed on in the position of Vice President. During the period 1920, 1921 and 1922 I had direction of the filing of income tax returns. These returns were filed with the Collector of Internal Revenue at Birmingham, Alabama. The returns of the Meridian & Memphis Railway Company were filed at the same place.

[fol. 119] The Meridian & Memphis Railway Company bonds were pledged as collateral for some collateral trust notes of the Equitable Loan & Mortgage Company at the time we bought the stock of the Meridian & Memphis Railway Company. When we paid off the collateral trust notes at the end of Federal Control through the War Finance Corporation we came into possession of the Meridian & Memphis bonds.

We might have paid off the collateral trust notes at the time we bought the stock and took part possession of the bonds concurrently with the possession of the stock but we did not do that. The collateral trust notes matured during Federal Control and the War Finance Corporation took them up for us and we came into possession of the bonds after the end of Federal Control.

Mr. R. E. DeNeefe, a witness on behalf of Petitioner, testified on Direct Examination:

My name is R. E. DeNeefe. I reside in Mobile, Alabama, and am Comptroller of the Gulf, Mobile & Northern Railroad Company. As such I have supervision over all the accounting departments of the Company. I am familiar with the transaction involving the charge off by the Meridian & Memphis Railway Company of bonds discount in the amount of $4,585.32 in each of the years 1924, 1925, and 1926.

Bonds of the Meridian & Memphis Railway Company were sold from 1913 at various dates down through 1916. They had an authorized—their mortgage authorized an is-[fols. 120 & 121] suance of $800,000 worth of five per cent gold bonds. They actually issued $675,000 of bonds, disposed of those between the years 1913 and 1916 at a dis-

count of something like $131,000.00. Those bonds were sold by the Meridian & Memphis to the Equitable Loan & Mortgage Company of Mobile, as I said before between 1913 and 1916.

In the latter part of 1917 and the early part of 1918 the Gulf, Mobile & Northern Railroad Company made purchase of those bonds from the Equitable Loan & Mortgage Company, not the Meridian & Memphis. The bonds were bought there for something like $636,000. The deal was made effective and consummated as of January, 1918.

Under the rules of the Interstate Commerce Commission the discount would have to be spread over the life of the bonds. The bonds were issued as of January 1, 1913, thirty year bonds, so that we would amortize each year one-thirtieth of the total discount. That was done by the old Meridian & Memphis Railway Company on its books, and was continued after the Gulf, Mobile & Northern Railroad Company took over the bookkeeping of the Meridian & Memphis.

These items for these three years in question represented the amortization of that discount.

On cross-examination witness testified as follows:

I am not qualified to answer the question whether the Gulf, Mobile & Northern Railroad Company and the Meridian & Memphis Railway Company were affiliated at the time the former bought the bonds of the latter. Those bonds were purchased in 1918 and I have stated what our records show as to the discount on those bonds. Those records are here in Court and can be verified.

The Gulf, Mobile & Northern Railroad Company did not own the stock on the date the bonds were acquired. It acquired the stock and bonds simultaneously as I understand it. Probably Mr. Hicks can answer that.

The corporations were affiliated during the years on appeal and during the years in which we are claiming a deduction for the discount.

[fol. 122] The foregoing is a true and correct statement of all the proceedings which took place and of all the evidence which was offered at the hearing before the Board of Tax Appeals on April 2, 1930, which are material to the

issues now raised in the petition for review by the Court of Appeals, District of Columbia, filed by the Gulf, Mobile & Northern Railroad Company.

Geo. E. H. Goodner, Counsel for Petitioner. Address: Munsey Building, Washington, D. C

I have no objection to the foregoing statement.

C. M. Charest, General Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Approved and settled this 20th day of October, 1932.

C. M. Trammell, Member U. S. Board of Tax Appeals.

[fol. 123] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Dockets Nos. 24887 and 42150

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed Oct. 18, 1932

To Mr. B. D. Gamble, Clerk of the U. S. Board of Tax Appeals:

Will you please include in the transcript of record for the Court of Appeals, District of Columbia, the following:

1. The docket entries of proceedings before the Board.

2. The pleadings before the Board which should include the following:

a. Petition No. 24887 filed March 3, 1927.

b. Answer filed June 22, 1927.

c. Amended answer filed March 8, 1930.

d. Amended petition filed April 2, 1930.

e. Answer to amended petition dictated orally at the hearing on April 2, 1930 (copy from pages 7-14 of transcript attached hereto).

f. Petitioner's reply to answer to amended petition dictated orally at the hearing on April 2, 1930 (copy from pages 14-16 of transcript attached hereto).

g. Petition No. 42150 filed December 31, 1928.

h. Answer to 42150 filed ——, ——.

3. The findings of fact and opinion of the Board promulgated February 20, 1931.

4. The Board's decision entered Sept. 30, 1931.

5. The Board's revised decision entered Nov. 7, 1931.

6. Respondent's motion filed Dec. 4, 1931.

7. Board's order entered December 19, 1931.

8. Board's order entered Dec. 21, 1931.

9. Board's second revised decision entered Jan. 25, 1932.

[fols. 124–126] 10. The stipulation as to the court of review.

11. The petition for review.

12. The statement of evidence.

13. This præcipe.

Respectfully, Geo. E. H. Goodner, Attorney for Petitioner. Address: Munsey Building, Washington, D. C.

Service of copy of above præcipe on me this 18th day of October, 1932, accepted.

C. M. Charest, General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

Clerk's certificate to foregoing transcript omitted in printing.

127 Monday, July 17th, A. D. 1933.

GULF, MOBILE & NORTHERN RAILROAD CO., Appellant,
vs.
DAVID BURNET, Commissioner of Internal Revenue. } No. 5854.

On consideration of the motion filed herein by counsel for the appellant to substitute Guy T. Helvering, Commissioner of Internal Revenue, for David Burnet, retired, and counsel for the Commissioner of Internal Revenue expressly consenting thereto, it is ordered by the Court that Guy T. Helvering, Commissioner of Internal Revenue, be and he is hereby substituted as party appellee in the above entitled cause in the place and stead of David Burnet, retired.

128 Tuesday, November 7th, A. D. 1933.

GUY T. HELVERING, Commissioner of Internal Revenue, Appellant,
vs.
GULF, MOBILE AND NORTHERN RAILROAD CO. } No. 5853.

and

GULF, MOBILE & NORTHERN RAILROAD CO., Appellant,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue. } No. 5854.

The argument in the above entitled causes was commenced by Mr. G. E. H. Goodner, attorney for the taxpayer, and was continued by Mr. M. K. Rothschild, attorney for the Commissioner of Internal Revenue.

(Mr. Justice Van Orsdel not sitting.)

129 Wednesday, November 8th, A. D. 1933.

GUY T. HELVERING, Commissioner of Internal Revenue, Appellant, vs. GULF, MOBILE and NORTHERN RAILROAD Co. — No. 5853.

and

GULF, MOBILE & NORTHERN RAILROAD Co., Appellant, vs. GUY T. HELVERING, Commissioner of Internal Revenue. — No. 5854.

The argument in the above entitled causes was continued by Mr. M. K. Rothschild, attorney for the Commissioner of Internal Revenue, and was concluded by Mr. G. E. H. Goodner, attorney for the taxpayer.

(Mr. Justice Van Orsdel not sitting.)

130 Court of Appeals of the District of Columbia

No. 5853

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE petitioner

v.

GULF, MOBILE & NORTHERN RAILROAD COMPANY, respondent

No. 5854

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE respondent

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On Petitions for Review of the Decision of the United States Board of Tax Appeals

(*Argued Nov. 8, 1933. Decided May 14, 1934.*)

G. A. Youngquist, Sewall Key, Morton K. Rothschild, special assistants to the Attorney General; *E. Barrett Prettyman,*

general counsel, Bureau of Internal Revenue; and *E. C. Algire*, special attorney, Bureau of Internal Revenue, all of Washington, D. C., for petitioner.

Geo. E. H. Goodner, of Washington, D. C., for respondent.

Before Martin, Chief Justice, and Robb, Hitz, and Groner, Associate Justices.

MARTIN, *Chief Justice:* These cases relate to income taxes for the years 1920 to 1926. They were heard together by the Board of Tax Appeals and will be considered together by us in this decision.

The issues arise upon the consolidated income-tax return for the year 1920, of the Gulf, Mobile and Northern Railroad Company, and its affiliates, the Meridian and Memphis Railway Company and the Jackson and Eastern Railway Company.

The Gulf, Mobile and Northern Railroad Company, hereinafter called the railroad company, was the owner and in control of a railroad system extending through several southwestern States, and on December 26, 1917, its properties including
131 those of the affiliated companies were taken over by proclamation of the President of the United States, acting under the Federal Control Act of March 21, 1918, and were operated by the Director General of Railroads during the period of Federal control, namely, from January 1, 1918, to midnight February 29, 1920.

Prior to Federal control the railroad company had commenced the construction of a line of railroad in Mississippi known as the "Blodgett Branch," and an extension of its railroad in Tennessee, known as the "Jackson Extension." Both of these projects were for the purpose of removing timber from virgin territories. The "Blodgett Branch" was completed and put into operation during the year 1918, and the "Jackson Extension" was completed and put into operation in September, 1919. These extensions when completed were likewise taken under Federal control and operated by the Director General as part of the system.

The Federal Control Act, enacted March 21, 1918 (40 Stat. 451), provides in part as follows:

"SEC. 1. That the President, having in time of war taken over the possession, use, control, and operation (called herein Federal control) of certain railroads and systems of transporta-

tion (called herein carriers), is hereby authorized to agree with and to guarantee to any such carrier making operating returns to the Interstate Commerce Commission, that during the period of such Federal control it shall receive as just compensation an annual sum, payable from time to time in reasonable installments, for each year and pro rata for any fractional year of such Federal control, not exceeding a sum equivalent as nearly as may be to its average annual railway operating income for the three years ended June thirtieth, nineteen hundred and seventeen. * * *

"SEC. 2. That if no such agreement is made, or pending the execution of an agreement, the President may nevertheless pay to any carrier while under Federal control an annual amount, payable in reasonable installments, not exceeding ninety per centum of the estimated annual amount of just compensation * * *."

* * * * * * * * * * *

"SEC. 4. That the just compensation * * * shall be increased by an amount reckoned at a reasonable rate per centum to be fixed by the President upon the cost of any additions and betterments, less retirements, and upon the cost of road extensions to the property of such carrier made by such carrier with the approval of or by order of the President while such property is under Federal control."

In this instance the railroad company did not enter into the "standard agreement," its compensation therefore fell within the provisions of section 2 and 4 of the act.

In the final settlement with the Director General in the year 1920, the railroad company was allowed the sums respectively of $75,000 and $56,521.02, as additional compensation to it for the use of its "Blodgett Branch" and "Jackson Extension," during parts of the Federal control period. These amounts were based upon an estimate of the earnings which would have accrued to the railroad company during the period of Federal control if the projects were put into operation, and the
132 railroad company had been permitted to operate them itself. No part of either of these amounts was included by the railroad company in the consolidated net taxable income return as reported to the Commissioner of Internal Revenue for the year 1920. The Commissioner, however, held that the total amounts thus received in 1920, constituted taxable income for that year, and determined a deficiency accordingly, from

which decision the railroad company appealed to the Board of Tax Appeals.

It appears that the railroad company and its affiliates kept their accounts and made their tax returns upon the accrual basis, and the Board of Tax Appeals held that the amounts thus received by them constituted taxable income accruing during the years 1918, 1919, and part of 1920, comprising the period of Federal control, and were to be prorated proportionately during such periods. Accordingly the Board redetermined the deficiency declared by the Commissioner and held that only such proportion of the compensation aforesaid as was proratably allocable to the period from January 1 to March 1, 1920, should be included in the return for the year 1920.

The Commissioner, as petitioner in case no. 5853, supra, contends that the Board of Tax Appeals erred in holding that the amount of compensation paid by the Director General to the railroad company for the use of the extensions should be assessed proratably during the period of Federal control, contending that the amounts were not determined nor paid until the final settlement in 1920, and that they accrued in their entirety and were returnable in that year.

The question thus presented is whether the amounts paid as aforesaid by the Director General to the railroad company for the use of the extensions in the year 1920, but covering the entire period of Federal control, should be allocated proratably for income-tax purposes between the 2 years and 2 months of Federal control, or should be returnable in their entirety for the year 1920. The Board as stated, held against the Commissioner upon this proposition.

It has been invariably held by the Board of Tax Appeals and the courts that the "just compensation," allowed and paid by the Director General in the final settlement for use of a railroad company's property during the Federal-control period, constitutes income accruing proratably over the entire period of control. *Illinois Terminal Co.*, 5 B. T. A. 15; *The K. C. Southern Ry. Co.*, 16 B. T. A. 665, affirmed (8th C. C. A.) 52 F. (2d) 372; *Midland Valley Railroad Co.*, 19 B. T. A. 423, affirmed (10th C. C. A.) 57 F. (2d) 1042; *Helvering* v. *St. Louis S. W. Ry. Co.*, 66 F. (2d) 633 (certiorari denied, April 2, 1934), — U. S. —; *Continental Tie & Lumber Co.* v. *United*

States, 286 U. S. 290. From an income-tax standpoint we are unable to see any difference between the compensation paid for the use of the property held and used throughout the Federal-control period, and compensation for the use of property held and used during part of such period. The language of the act indicates that the compensation payable to the carriers should be payable in annual sums for the use of their property. Even if the compensation be determined and agreed upon at a later date and paid in a lump sum, it is still compensation which accrues during the period of control and use. It may be noted again that the taxpayer in this case was on the accrual basis of accounting and rendering tax returns. The question therefore is when did the income under review accrue in contemplation of the act. The Board decided that it accrued proratably throughout the
133 period during which the property was in the control and use of the Government. This decision is sustained by the fact that in the respective years of Federal control a reasonable estimate of "just compensation" could be made for the use of the two extensions and the facts upon which the obligation rested existed. It follows that the income in question accrued to the railroad company proratably during the control period as held by the Board of Tax Appeals. In our opinion therefore the decision of the Board of Tax Appeals in case no. 5853 was correct and should be affirmed.

In case no. 5854 the railroad company as petitioner complains of the determination of the Commissioner of Internal Revenue upon two grounds.

As a first cause of complaint it alleges that among the properties of the railroad company taken over by the President on December 3, 1917, were certain materials and supplies which had cost the company $286,664.26. The Director General at the end of the control period turned back certain materials and supplies the cost and value of which was $275,912.03. In the final settlement the company was allowed the sum of $61,314.18 on its claim for shortages in the inventory of materials and supplies turned back by the Director General as compared with those turned over to him at the beginning of the period.

In computing the company's net income for 1920 the Commissioner included therein as taxable income the sum of

$50,561.95, arrived at by taking from the sum of the inventory of materials and supplies turned back plus the amount allowed taxpayer in the final settlement, the amount of the original inventory. The Board of Tax Appeals approved this action of the Commissioner. It is claimed by the company that this was error.

We can not agree with this contention. Article 49 of Treasury Regulations 45 (1920) provides that where the owner of property has transferred title by reason of the exercise of the power of eminent domain, and has received compensation in excess of its cost or value on March 1, 1913, and the owner does not elect to replace or restore the property, the transaction will be deemed to be completed, and the excess of the value received over the cost or value on March 1, 1913, is subject to tax as if resulting from a sale. This provision has been included in the Treasury Regulations from 1918 until 1933. The reenactment of the statutory provision without material change must be deemed to constitute legislative approval of the administrative construction. *Brewster* v. *Gage*, 280 U. S. 327, 337.

The Circuit Court of Appeals for the Second Circuit upheld the regulations in question in *Lehigh & Hudson River Ry. Co.* v. *Commissioner*, 36 F. (2d) 719, certiorari denied, 281 U. S. 748. In that case, which involved similar circumstances, the court said:

"Such a transaction is equivalent for tax purposes to a sale of the supplies at the agreed price. The act of 1918 (40 Stat. 1057), did not, indeed, expressly provide for gains arising from the requisition of property, but article 49 of the regulations did: 'When the owner of property has lost or transferred title by reason of requisition or eminent domain * * * if the taxpayer does not elect to replace or restore the property, the transaction
will then be deemed to be completed and the income
134 shall be measured by the excess of the amount of the
compensation over the cost of the property.' This article and article 50 prescribed the formalities by which the election should be manifested, with none of which the railway conformed * * *."

In our opinion the foregoing contention of the railroad company must be overruled.

As second cause of complaint the railroad company contends that from 1913 to 1916, inclusive, its subsidiary, the Meridian and Memphis Railway Company, sold its corporate bonds at a

discount, and under the Interstate Commerce Commission's rules it set up on its books the amount of the discount as deferred charges to be amortized over the remaining life of the bonds; that the subsidiary company had consistently written off each year the applicable part of such discount, and in each of the years 1924, 1925, and 1926 it wrote off $4,585.32. The railroad company accordingly claimed an equal sum as a deduction in the consolidated tax returns for those years. The Commissioner disallowed the deduction on the ground that the bonds had been purchased and were held by the affiliated railroad company, and that the sum of the annual amortization was an inter-company obligation, and was not deductible.

Article 636 of Treasury Regulations 65 relates to the Revenue Act of 1924, and provides that intercompany transactions are subject to elimination from the consolidated taxable net income of the affiliated corporations. Article 635 of Treasury Regulations 69 relating to the Revenue Act of 1926 contains the same provision. In the instant case one member of the affiliated group acquired the bonds of another member. The Treasury Department has consistently construed such a transaction to be an intercompany transaction and has consistently held that it should be eliminated from a return of the consolidated taxable net income. *Old Mission Portland Cement Co.*, 25 B. T. A. 305, affirmed C. C. A. 9th, March 12, 1934, —F. (2d) —. We conclude therefore that the Board was right in holding that no deduction was allowable in the consolidated return of the railroad companies because of the amount entered by the affiliated company upon its books for the annual amortization of its bonds which at the time were held by its associate company.

Accordingly in each of the two cases, to wit, no. 5853 and no. 5854, the decision of the Board of Tax Appeals is affirmed.

A true copy.

Test:

Mr. Justice Groner concurs in the conclusion.

Clerk, Court of Appeals, D. C.

135 Monday, May 14th, A. D. 1934.

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue.
No. 5854, April Term, 1934.

Petition for review from the Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

per Mr. Chief Justice Martin,
May 14, 1934.

Mr. Justice Groner concurs.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

136 Monday, June 25th, A. D. 1934.

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.
No. 5854.

Modification.

Now on this 25th day of June, 1934, the court upon a reconsideration of its judgment in cases number 5853 and 5854 enters a modification thereof to the following effect to wit: It appearing that in the decision of the Board of Tax Appeals the sum of $4,000 of additional compensation paid to the petitioner, the Gulf, Mobile and Northern Railroad Company, for carrying the mails in 1916 and 1917 was included in petitioner's taxable income as determined for the year 1920 and that petitioner duly excepted thereto; and it appearing that the respondent, the commissioner of Internal Revenue, in his brief filed in this court in the present appeal conceded that

under the facts as found by the Board of Tax Appeals the additional compensation aforesaid for the transportation of mail should not be accrued during the year 1920 as was found and ordered by the Board; the court now modifies its decision as heretofore entered in case No. 5854 and affirms the decision of the Board made therein but nevertheless reverses that part of the decision affecting the $4,000 item now referred to, with instructions that the said amount of $4,000 should not be considered as accrued in the year 1920, and that petitioner's taxes for that year be recomputed accordingly.

137 UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Appellant, *v.* GUY T. HELVERING, as Commissioner of Internal Revenue (substituted for David Burnet), Respondent.	No. 5854.

Præcipe.

Mr. Henry W. Hodges, Clerk,
United States Court of Appeals, D. C.
Sir:

Will you kindly prepare and certify for filing in the Supreme Court of the United States, the record in the above designated cause, including therein

1. The printed record before the Court from the Board of Tax Appeals.
2. The Court's order substituting Helvering for Burnet.
3. The argument and submission.
4. The Court's Opinion.
5. The Court's Decree.
6. The Court's Order Modifying Opinion and Decree.
7. This præcipe.
8. Your certificate.

Respectfully,

(Signed) GEO. E. H. GOODNER,
Attorney for Appellant.

Dated September 20, 1934.

Address: Munsey Bldg.,
Washington, D. C.

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No. 5854.

GULF, MOBILE & NORTHERN RAILROAD COMPANY
Appellant
v.
GUY T. HELVERING, et al
Respondent.

ORDER FOR RECORD

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

Filed September 20, 1934.
HENRY W. HODGES,
Clerk.

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UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

I, HENRY W. HODGES, Clerk of the United States Court of Appeals for the District of Columbia, do hereby certify that the foregoing printed and typewritten pages numbered from 1 to 138, inclusive, are a true copy of the transcript of record and proceedings of said Court of Appeals as designated by counsel in the case of

Gulf, Mobile & Northern Railroad Co., Appellant,

vs.

Guy T. Helvering, Commissioner of Internal Revenue, No. 5854, April Term, 1934, as the same remain upon the files and records of said Court of Appeals.

IN TESTIMONY WHEREOF, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the City of Washington, this 20th day of September, A. D. 1934.

HENRY W. HODGES,
Clerk of the United States Court of Appeals for the District of Columbia.
By: MONCURE BURKE,
Deputy Clerk.

[SEAL]

[fol. 140] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 5, 1934

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted, limited to the question of the right of the taxpayer to deductions on account of amortization of bond discount, and the case is assigned for argument immediately following No. 107.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 141] SUPREME COURT OF THE UNITED STATES

STIPULATION AS TO PRINTING RECORD—Filed Nov. 6, 1934

The above designated parties, through their respective attorneys, hereby agree and stipulate that, in printing the additional copies of the Transcript of Record under the Court's Order entered November 5, 1934, wherein it granted the Petition for Writ of Certiorari, limited to the question of the right of the taxpayer to take deductions on account of amortization of bond discount, the following parts of the printed record, which are not material to the issue to be considered by the Court, shall be omitted, namely:

1. Commencing with line 1 on page 1 and continuing through and including the last line on page 4.
2. Commencing with line 29 on page 7 and continuing to but not including line 19 on page 30.
3. Commencing with line 25 on page 51 and continuing to but not including line 22 on page 53.
4. Commencing with line 16 on page 54 and continuing to but not including line 11 on page 56.

[fol. 142] 5. Commencing with line 30 on page 56 and continuing to but not including line 15 on page 61.

6. Commencing with line 1 on page 62 and continuing to but not including line 22 on page 66.
7. Commencing with line 24 on page 66 and continuing to but not including line 16 on page 88.

8. Commencing with line 29 on page 88 and continuing to but not including line 28 on page 96.

9. Commencing with line 19 on page 112 and continuing to but not including line 14 on page 119.

10. Commencing with line 39 on page 120 and continuing to but not including line 21 on page 122.

11. Commencing with line 1 on page 125 and continuing to but not including line 8 on page 126.

Geo. E. H. Goodner, Attorney for Petitioner.
J. Crawford Biggs, Solicitor General.

Endorsed on cover: File No. 39,041. U. S. Court of Appeals, District of Columbia. Term No. 413. Gulf, Mobile & Northern Railroad Company, petitioner, vs. Guy T. Helvering, as Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed September 25, 1934. File No. 413, O. T., 1934.